Supreme Court, U.S.
FILED
JAN 3 1990
JOSEPH F. SPANIOL, JR.
CLERK

(6)

No. 88-1951

In the Supreme Court of the United States

OCTOBER TERM, 1989

UNITED STATES OF AMERICA, PETITIONER

v.

FRANCES L. DALM

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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In our opening brief, we point out (Br. 10) that respondent did not file her claim for a refund of gift tax within the period required by the applicable statute of limitations. 26 U.S.C. 6511.[1] Since respondent failed to act within the limitations period, there is no statutory basis for jurisdiction over this suit, and the district court therefore properly dismissed it. Br. 8-11. We also show that the doctrine of equitable recoupment, as applied by this Court in tax cases, provides no basis for jurisdiction over an independent, time-barred refund suit such as respondent's. Br. 11-19. Rather, that doctrine allows a tax claim over which a court properly has jurisdiction "to be examined in all its

[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

aspects." *Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. 296, 299 (1946). In such a case, where jurisdiction properly lies, a party may offer the existence of a previous overpayment as an equitable reason why the deficiency being litigated should be reduced. Respondent's proposed expansion of the doctrine of equitable recoupment would not only eviscerate clear jurisdictional limitations, it would also render nugatory the restrictions that Congress has imposed upon the availability of relief under the mitigation provisions of the Internal Revenue Code, I.R.C. §§ 1311-1314. Br. 25-27. Finally, we show in our opening brief that the jurisdictional limitations do not operate unfairly here. Respondent could have pursued a procedural course that would have permitted her properly to invoke the doctrine of equitable recoupment; she simply failed to do so. Br. 30-34.

Respondent's brief does not squarely address these arguments. Instead, she makes several contentions which, as we shall show, either lack merit or miss the point.

1. Respondent argues, first, that this case is indistinguishable from *Bull* v. *United States*, 295 U.S. 247 (1935), because in both cases the taxpayer paid a non-income tax, the government then asserted an income tax deficiency, and the taxpayer unsuccessfully opposed the deficiency in the Tax Court or its predecessor (the Board of Tax Appeals) and then filed a claim and suit for refund.

Respondent's contention overlooks the critical distinction between *Bull* and this case. In *Bull*, the taxpayer followed the correct procedure for challenging the amount of income tax deficiency. Under the pre-1926 law applicable in that case, a taxpayer could petition the Board of Tax Appeals to review a deficiency asserted by the Commissioner and, if unsuccessful, file a refund claim and obtain de novo review in a district court or the Court of Claims. See Sections 274(a), (b), and (c), 308(a), (b),

and (c), 900(g), 1025 of the Revenue Act of 1924, ch. 234, 43 Stat. 297, 308-309, 337, 348. As a consequence, the district court in *Bull* properly had jurisdiction over the income tax refund suit.

That is not the case here. As noted in our opening brief (Br. 13 n.6), the law no longer allows a taxpayer resort to two different forums to contest the same income tax deficiency. Sections 284(d), 1001-1003 of the Revenue Act of 1926, ch. 27, 44 Stat. 67, 109-110, made the decisions of the Board of Tax Appeals (now the Tax Court) final, subject only to appellate review by the courts of appeals and this Court. Thus, once respondent filed a petition in the Tax Court for redetermination of her *income* tax liability for 1976 and 1977, she was precluded from thereafter suing for a refund in respect of that liability. I.R.C. § 6512(a); *Elbert* v. *Johnson*, 164 F.2d 421 (2d Cir. 1947); Andrews, *Modern-Day Equitable Recoupment and the "Two Tax Effect:" Avoidance of the Statutes of Limitation in Federal Tax Controversies*, 28 Ariz. L. Rev. 595, 599 n.20, 614-615 (1986). To circumvent this obstacle, respondent instead filed a tardy claim and brought suit for a refund of the *gift* tax she had paid. Because that claim was time-barred, the district court lacked jurisdiction and properly dismissed the suit.

Far from being a "meaningless procedural distinction" (Resp. Br. 2), the difference between filing a timely claim (as did the taxpayer in *Bull*) and failing to file such a claim (as did respondent here) is the difference between preserving jurisdiction in the district court to consider a claim of equitable recoupment and failing to preserve that jurisdiction. Indeed, with proper attention to the significance of that difference, equitable recoupment remains fully available under modern procedure—contrary to respondent's contention that only her position would maintain the vitality of the doctrine. If instead of proceeding in the Tax Court, respondent had paid the 1976 and 1977 income tax

deficiencies and then brought a timely refund suit in district court or the Claims Court, she could properly have invoked *Bull*'s doctrine of equitable recoupment to diminish the amount of the income tax deficiency by the amount of the gift tax she had paid.[2] Having failed to follow this available course, however, she should not now be heard to complain about the consequences that attend her choice of forum and remedies.[3]

2. Respondent next argues that her action was, in fact, timely. According to respondent, since no gift tax was actually due in 1976, there was no "payment" of gift tax in that year for purposes of Section 6511 of the Code. Rather, without citation of authority, respondent asserts that when two taxes have been paid with respect to a single transaction under inconsistent theories of taxation, the "improper tax" somehow "becomes paid"—and therefore triggers the running of the limitations period—only at the time that the proper tax has been determined. Resp. Br. 6. Accordingly, respondent contends that her cause of action "arose" only in 1984 when the income tax was collected (Resp. Br. 8) because "the gift tax only became refundable upon the payment of income tax on the same sum of money because *then and only then* was the gift tax overpaid." Resp. Br. 7 (emphasis in the original).

Respondent's view accords neither with the statute nor with common sense. There is no statutory support for the notion that some taxes are not deemed paid until actions

[2] Hence, there is no basis for respondent's assertion that she has had "no fair opportunity to be heard." Resp. Br. 9.

[3] Indeed, to allow respondent to maintain an untimely suit in the district court after litigating her income tax deficiency in the Tax Court would give respondent "two bites at the apple" of reducing her liability on the "single transaction" or taxable event that she asserts is at issue. To the contrary, Congress determined in 1926 to limit taxpayers to one forum of their choice.

by the government make it clear that the payments were erroneous. To the contrary, Section 6511 of the Internal Revenue Code states simply that the limitations period on filing a claim for refund runs "3 years from the time the return was filed or 2 years from the time the tax was paid," whichever period expires later. Consistently with the plain language, a tax is "paid" under the Code when the Commissioner receives a check in payment of the tax (unless the check is subsequently dishonored). See I.R.C. §§ 6151, 6311.

Common sense does not support the notion that no payment of gift tax occurs when a tax so labeled is paid on an item that does not warrant it; rather, a gift tax has simply been paid erroneously. Payment of an income tax in this case did not "render[] the original payments improper" (Resp. Br. 7)—to the extent they were improper, they were improper and refundable from the time the original gift tax payments were made. Payment of the second tax simply made evident the improper nature of the first tax. Even at that time, a remedy is readily at hand—a claim of equitable recoupment could properly have been raised in the context of a suit for refund of the second tax (a course respondent did not follow).[4]

A contrary holding—that an erroneous tax has not been paid until it has been determined whether the payment was erroneous—would eviscerate the statute of limitations, which by its very nature is intended to bar untimely tax refund claims without consideration of the question whether

[4] A taxpayer can also file a protective claim for refund or obtain an extension of the limitations period from the IRS if there is reason to believe that there will be a determination after the expiration of the limitations period that will bear on his or her right to refund. See M. Saltzman, *IRS Practice and Procedure* § 11.08[3] (1981); I.R.C. § 6511(c); *O'Brien* v. *United States*, 766 F.2d 1038, 1041 n.3 (7th Cir. 1985).

the taxes sought to be refunded were properly imposed. And, if respondent were correct, the mitigation provisions enacted by Congress would be superfluous, as no limitations period would bar correction of inconsistent tax treatment of income.

In a further attempt to support her claim that the instant suit is timely, respondent argues (Resp. Br. 9) that the government "has waived any sovereign immunity by bringing an action [*i.e.*, by asserting income tax deficiencies for 1976 and 1977] against the Dalms," and has thereby "opened itself up to claims of recoupment against that deficiency." To be sure, Congress has waived sovereign immunity and provided taxpayers with remedies when tax deficiencies are asserted against them. Respondent chose to take advantage of this waiver by proceeding in the Tax Court (instead of in a district court or the Claims Court following payment of the tax) to challenge the imposition of income tax deficiencies against her. But, as we have explained (pp. 3-4, *supra*), respondent's choice of the Tax Court forum precluded her from claiming equitable recoupment against the income tax deficiency.[5]

[5] Respondent errs in relying (Resp. Br. 7-8) on *Elbert* v. *Johnson*, 164 F.2d 421 (2d Cir. 1947); indeed, the holding in that case accords with our position. The taxpayers there sought to recover a prior gift tax payment by invoking equitable recoupment in a Tax Court proceeding concerning income tax liability arising out of the same transaction. The Tax Court determined that it lacked jurisdiction to grant equitable recoupment. 164 F.2d at 423; see *Commissioner* v. *Gooch Milling & Elevator Co.*, 320 U.S. 418 (1943). The taxpayers then sought to raise the recoupment claim by filing an income tax refund action. The district court dismissed for lack of jurisdiction; the court of appeals affirmed. Assuming that the taxpayers could have raised an equitable recoupment claim if they had filed suit without resorting first to the Tax Court (*Elbert*, 164 F.2d at 423), the court held their refund suit barred by Section 322(a) of the 1939 Code, 26 U.S.C. (1952), the provision which at the time prohibited a refund action with respect to a tax that was the subject of a prior Tax Court proceeding. (The provision is currently codified at I.R.C. § 6512(a).)

Respondent cites a passage that is dictum within a concurring opinion. Resp. Br. 8 (citing *Elbert*, 164 F.2d at 425). The concurrence, while right in result, is incorrectly premised on the assumption that equitable recoupment can "toll" the limitations period for challenging a previously paid tax, independent of timely litigation over a subsequently paid tax. To the contrary, this Court stated in *Bull* that inconsistent treatment of a particular transaction "cannot avail to toll the statute of limitations." 295 U.S. at 259.

3. In *Bull*, this Court observed that the defense of equitable recoupment is never barred by a statute of limitations "so long as the main action itself is timely." 295 U.S. at 262. Respondent contends (Resp. Br. 16-17) that the "main action" for this purpose is the government's assertion of an income-tax deficiency. Because her suit "follow[s] a timely assertion of a deficiency on the part of the government," respondent argues that it is not an "independent action" within the meaning of cases holding that the doctrine of equitable recoupment cannot provide an independent basis for jurisdiction over an otherwise time-barred suit. Resp. Br. 13-16.[6]

Respondent's argument fundamentally misconceives how the doctrine of equitable recoupment operates. As we explain in our opening brief (Br. 18-19), the "main action" is an action over which the court properly has jurisdiction (which requires, *inter alia*, that it be brought upon a timely claim). A time-barred claim may be asserted *in the main action* as a defense or offset against the timely claim under the doctrine of equitable recoupment, provided that the untimely claim arises from the same transaction as the

[6] *O'Brien* v. *United States*, 766 F.2d 1038, 1048-1051 (7th Cir. 1985); *Ellard* v. *United States*, 228 Ct. Cl. 815 (1981); *Brigham* v. *United States*, 470 F.2d 571, 577 (Ct. Cl. 1973), cert. denied, 414 U.S. 831 (1973); *Evans Trust* v. *United States*, 462 F.2d 521, 526 (Ct. Cl. 1972).

timely claim.[7] Thus, under the rationale of *Bull*, a deficiency asserted by the government may provide the basis for a "main action" if the deficiency is actually assessed and either the taxpayer fails to pay it and the government brings a timely collection action thereon, or the taxpayer pays the deficiency, files a timely claim for refund, and then brings a timely refund suit. See *Bull*, 295 U.S. at 260-262. In either of these events, the pending refund or collection suit would be the "main action" within the meaning of *Bull*, and the taxpayer could seek to "recoup" an appropriately related, time-barred refund claim against the tax liability asserted by the government—as a *defense* in the pending action challenging the government's deficiency determination.

On the other hand, as we have explained (U.S. Br. 28), the existence of a timely asserted deficiency claim is neither a necessary nor a sufficient element of an equitable recoupment claim. Respondent thus overlooks the premise of statements she quotes which note that equitable recoupment "permits a taxpayer to recoup an erroneously paid tax * * * against a timely and correctly asserted deficiency by the government." Resp. Br. 16 (quoting *O'Brien* v. *United States*, 766 F.2d 1038, 1049 (7th Cir. 1985)). The point of such statements is that equitable recoupment can be invoked when there is a claim that is still being or can properly be litigated—such as a deficiency that is still "open" against which a time-barred overpayment can be

[7] All of the cases invoked by respondent (see Resp. Br. 17 n.1) that were cited in *Bull* make the same point that equitable recoupment is in the nature of a *defense*. Hence, a recoupment claim does not resurrect an untimely independent refund claim; rather, it reduces a presently owed debt. See *Williams* v. *Neely*, 134 F. 1, 5 (8th Cir. 1904) ("Recoupment is the keeping back of something that is due because there is an equitable reason for holding it.").

recouped.[8] Here, respondent has effectively barred herself from bringing a recoupment claim: after her petition in the Tax Court, there can be no "open" deficiency that she can continue to litigate. The Tax Court's determination of the deficiency is final, and respondent's subsequent suit can only be an "independent action" on a time-barred claim.[9]

4. Respondent misperceives the thrust of our argument regarding the significance of the "mitigation provisions" of the Internal Revenue Code (I.R.C. §§ 1311-1314). Our position is not that those provisions provide "the exclusive remedy when inconsistent positions of the

[8] In particular, respondent errs in relying on *O'Brien* as supporting the notion that equitable recoupment can be invoked to confer jurisdiction over an independent suit following the entry of a Tax Court decision. See Resp. Br. 16-17 (quoting *O'Brien*, 766 F.2d at 1050). The court in *O'Brien* was positing only that the invocation of equitable recoupment "might have been correct * * * in the 1975 [Tax Court] proceeding which resolved the dispute over stock valuation for estate tax purposes"—though invocation of the doctrine clearly was not correct after that proceeding in an independent suit for an income tax refund based on the corrected stock valuation. Correctly identifying the nature of equitable recoupment as a *defense* in a properly instituted suit, the *O'Brien* court simply declined to determine "whether the Tax Court currently possessed the equitable jurisdiction necessary to apply the equitable recoupment doctrine." 766 F.2d at 1050 n.15.

[9] Respondent notes that her gift tax refund claim was filed before the decision was entered in her Tax Court proceeding, arguing that her claim is thus one in recoupment that survives as long as the claim against which it may be asserted survives. Resp. Br. 17-18. Obviously, so long as the possibility remains that a court may obtain jurisdiction over a suit brought on the main claim, the possibility also remains that an appropriately related, though time-barred, claim might then be asserted *in that suit* as a defense against the main claim under the doctrine of equitable recoupment. It in no way follows, however, that the doctrine of equitable recoupment will support an independent action brought on a time-barred claim merely because that claim was filed while different proceedings on the main claim were still pending.

Internal Revenue Service subject a Taxpayer to double taxation." Resp. Br. 18-19. Rather, it is that if, as respondent contends and the court below held, equitable recoupment permits a taxpayer to bring an independent action on a time-barred claim for a refund of taxes assertedly overpaid merely because of inconsistent treatment by the Commissioner, it would have been pointless for Congress to have enacted the mitigation provisions because such actions could simply have been brought under the doctrine of equitable recoupment. Moreover, such an expansive view of equitable recoupment would render nugatory the carefully crafted restrictions that Congress imposed upon the availability of relief under the mitigation provisions. The very existence of the mitigation provisions confirms that the court of appeals' approach to equitable recoupment in this case was wrong. See U.S. Br. 25-27.[10]

5. Finally, respondent erroneously argues (Resp. Br. 20-23) that permitting her to pursue her time-barred refund claim would not contravene the underlying policy of the statute of limitations to preclude stale claims. Resp. Br. 20-23. We agree that both the payment of the gift tax by respondent and the later assessment of a deficiency and payment of another tax concerned one transaction that could have been examined "in all of its aspects" without offending the policies underlying the statute of limitations. Respondent, however, did not initiate such an

[10] Respondent further asserts (Resp. Br. 20) that "the Government seeks to use the statute of limitations in the precise manner disapproved of by Congress," that is, by "seek[ing] to make a profit [by] taking inconsistent positions." The government, however, has never taken inconsistent positions as respondent suggests. The record here plainly shows that since he examined the payments by Clarence Schrier to respondent, the Commissioner of Internal Revenue has steadfastly maintained that the payments were income to respondent for her services as administratrix of the estate of Harold Schrier.

inquiry into "all of [the] aspects" of the timely income tax controversy. Rather, while she labels her claim one of recoupment—*i.e.*, one "in the nature of a defense" to the income tax deficiency—she raises it after final determination of that deficiency. Such an action cannot be reconciled with the policy of repose effectuated by statutes of limitations. Further, respondent's stratagem would multiply litigation that could have been resolved in one suit. In any event, respondent's policy-based plea cannot negate the clear statutory language enacted by Congress which bars suits for refund such as this one, filed long after the challenged taxes were paid.

For the foregoing reasons, and those presented in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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JANUARY 1990

☆ U.S. GOVERNMENT PRINTING OFFICE: 1990—262-203/00091